

# **State Board of Embalmers and Funeral Directors**

December 8-9, 2015

Stoney Creek Hotel & Conference Center  
18011 Bass Pro Drive  
Independence, MO 64055

## **OPEN MINUTES**

The meeting of the State Board of Embalmers and Funeral Directors was called to order by Collin Follis, chairman, 10:32 a.m.

### **Roll Call**

#### **Board Members Present**

Collin Follis, Chairman

Gary Fraker, Vice Chairman

Jerald Dickey, Secretary

Kenneth McGhee, Board Member

Eric Pitman, Board Member - 12/8/15 not present, 12/9/15 attended intermittently – motions reflect when in attendance

Archie Camden, Public Board Member

#### **Staff Present**

Sandy Sebastian, Executive Director

Tabatha Lenzini, Administrative Assistant

Lori Hayes, Inspector

Lisa Wildhaber, Examiner Supervisor

Sharon Euler, Division Legal Counsel

Leslie Nehring, Chief Financial Examiner, Insurance Division

#### **Approval of Agenda**

A motion was made by Gary Fraker and seconded by Jerald Dickey to approve the amended open agenda. Motion carried with Archie Camden and Kenneth McGhee voting in favor with no votes in opposition. Eric Pitman not present for the meeting.

#### **Scope of Financial Examinations (Attachment A)**

Sandy distributed a staff/counsel recommendation for the upcoming round of financial examinations and a memo dated September 181, 2015 assembled by Lisa Wildhaber in response to the board's request to review techniques for sampling. Sharon reviewed highlights of staff/counsel recommendation and Lisa's memo and stated that a lot of time and thought was put into the process, including consideration of the board's and public's comments. Sharon and Sandy stated that they wanted to provide to the board ahead of the public session the following day to allow the board to review and also shared with the board that Leslie Nehring, Chief Financial Examiner with the Insurance division of the department would be present tomorrow to visit with the board about how financial examinations are done in that division.

#### **Move to Closed**

A motion was made by Kenneth McGhee and seconded by Gary Fraker to move into closed session for numbers 1, 2, 7, 8, and 9 of the attached motions to close. Motion carried with Archie Camden and Jerald Dickey voting in favor with no votes in opposition. Eric Pitman not present.

## **Executive Director Report**

Sandy shared with the board that Kristin Butler, financial examiner, had resigned and her last day was December 14, 2015.

Sandy reported that the financial report for October 2015 was enclosed showing the actual revenue and expenses of the board for the fiscal year thus far. She stated the projections were not yet finalized by the division accounting office and therefore the top page that is normally included was not. The board had no questions.

Sandy provided an update on the pending license system stating that the process was still underway; however the system was scheduled to go live December 1, 2015 and that timeline was not met.

Sandy shared that the reports for new licenses, closed/ceased licenses, disciplinary actions were included in the board's materials as informational.

Sandy shared with the board that upcoming conferences were as follows and asked the board if they would approve her to attend the FARB conference and stated that as a board director for The Conference she would be attending and if anyone was interested in attending.

- 40<sup>th</sup> Annual FARB Forum – January 28-31, 2016
- 112<sup>th</sup> Annual Meeting of The Conference – February 24-25, 2016

The board stated they had no concerns about Sandy attending both conferences and both Kenneth McGhee and Collin Follis expressed an interest in attending The Conference is division approves two board members to go.

## **Future Meeting Dates**

The board set the following dates and locations for future meetings.

March 15-16, 2016 board meeting in Jefferson City

June 14-15, 2016 in St. Louis

September 14-15, 2016 in Jefferson City

December 7-8, 2016 in Kansas City

## **Legal Counsel Report**

Sharon gave an update on National Prearranged Services (NPS) regarding PNC and National Bank having filed appeals in the case and that restitution paid to date by the NPS defendants was \$5,296,038

## **Approval of Minutes**

A motion was made by Jerald Dickey and seconded by Archie Camden to approve the following minutes.

May 28, 2013 Financial Examination Committee  
June 3, 2013 Financial Examination Committee  
July 10, 2013 Financial Examination Committee  
July 25, 2013 Financial Examination Committee  
August 6, 2013 Financial Examination Committee  
August 14, 2013 Financial Examination Committee  
August 27, 2013 Financial Examination Committee  
September 23, 2013 Financial Examination Committee  
October 21, 2013 Financial Examination Committee  
November 6, 2013 Financial Examination Committee  
December 16, 2013 Financial Examination Committee  
January 28, 2014 Financial Examination Committee  
February 10, 2014 Financial Examination Committee  
March 4, 2014 Financial Examination Committee  
March 18, 2014 Financial Examination Committee  
March 26, 2014 Financial Examination Committee  
April 30, 2014 Financial Examination Committee  
June 3, 2014 Financial Examination Committee  
July 15, 2014 Financial Examination Committee

July 22, 2014 Financial Examination Committee

August 5, 2014 Financial Examination Committee

Motion carried with Gary Fraker and Eric Pitman voting in favor with no votes in opposition. Kenneth McGhee abstained from voting.

### **Review of Proposed Rules (Attachment B)**

The board reviewed draft regulations.

#### **20 CSR 2120-3.525**

The board discussed the draft and expressed concerns regarding approval of the investment advisor and the seller being given notice if such changes because the seller is the licensee the board would hold accountable as it is the licensee regulated.

#### **What Constitutes Adequate Records for a Seller**

The board discussed the draft and comments, among others, were made regarding the acceptability of electronic records and that if the seller has a trustee that records are maintained somewhere.

A motion was made by Kenneth McGhee and seconded by Jerald Dickey to table both drafts and ask staff to rework them given the comments. Motion carried with Archie Camden and Gary Fraker voting in favor with no votes in opposition. Eric Pitman was not present.

### **Scope of Financial Examination (Attachment A)**

Sharon stated that the staff/counsel took the comments that were made during the previous discussions and worked diligently to review sampling techniques as well as rework the previous scope that was on the August 4-5, 2015 and August 10, 2015 meetings and develop the recommendation for 2016 that the board was reviewing. Sharon stated that Leslie Nehring, Chief Financial Examiner, with the Insurance division of the department agreed to come and talk to the board about how their examinations are conducted.

Leslie stated that insurance follows NAIC guidelines that provide basic authority but that they follow state law; that many years and revisions have gone into the guidelines used today; that insurance has of almost a staff 50; that they examine approximately 250 licensees; that they have 2 audit managers in charge of scheduling and they assign an examiner in charge. She stated that NAIC takes the best practices from across 56 jurisdictions and that the guidelines have been around for approximately 20 years. Leslie stated that they do 5 stages before sampling which includes understanding the company and reviewing quarterly reports, annual reports and reports from certified public accountants; reviewing internal controls; and that are times they would review 100% of the contracts, depending on the risk. She further stated that they examination reports are public. She stated that if there were any problems identified during sampling they would expand their review and that if underfunding is identified they require it be paid immediately and if not resolve they can move to put a company in administrative supervision and then receivership. Leslie stated that they have access to the companies web feeds to pull sampling from online purchases, have access to all computers of the company and passwords.

She suggested looking at more contracts rather than less because of how the funds are handled and that she felt it was appropriate to review 100% of all deposits and a sampling for consumer confirmation.

Sandy shared that out of 344 examinations completed, the top 5 exceptions noted were insurance assignments lacking a preneed contract, underfunding/shortages identified (approximately \$7.2million), seller was the owner of insurance policies after August 28, 2009, joint account titling, and contract language that conflicts with funding sources.

Members of the public questioned the consumer letter process; asked if there was a plan to adopt a plan that requires additional staff; questioned what the letter meant when seller received it stating examination file was being closed; questioned the board's authority regarding sellers making restitution; does the shortage reflect market loss. Members of the public also commented that maybe the board consider doing a percentage review based on those with no signatures; that the staff/counsel recommendation conflicted with what the board discussed during the rewrite of chapter 436 in 2009; and a request that the board look to add language to #4 of the recommendation to expand that if an examiner is offered an employment opportunity or has another conflict that they must notify their supervisors.

Following discussion a motion was made by Kenneth McGhee and seconded by Gary Fraker to table a decision to the January 6, 2015 meeting. Motion carried with Jerald Dickey, Eric Pitman and Archie Camden voting in favor with no votes in opposition.

#### **Open Session/Discussion**

No discussion

#### **Move to Closed**

A motion was made by Gary Fraker and seconded by Jerald Dickey to move into closed session pursuant to numbers 1, 2, 7, 8, and 9 of the attached motions to close. Motion carried with Kenneth McGhee and Eric Pitman voting in favor with no votes in opposition. Archie Camden was not present.

#### **Mark Collier - Probation Violation Hearing**

A motion was made by Kenneth McGhee and seconded by Gary Fraker to approve the request for continuance. Motion carried with Archie Camden, Eric Pitman and Jerald Dickey voting in favor with no votes in opposition

#### **Move to Closed**

A motion was made by Gary Fraker and seconded by Jerald Dickey to into executive session. Sharon asked him to state what specifically he wanted to go into executive session for. Motion was withdrawn.

A motion was made by Kenneth McGhee and seconded by Jerald Dickey to move into closed pursuant to numbers 1, 2, 7, 8 and 9 of the attached motions to close. Motion carried with Archie Camden, Gary Fraker and Eric Pitman voting in favor with no votes in opposition.

#### **Adjourn**

A motion was made by Eric Pitman and seconded by Jerald Dickey to adjourn. Motion carried with Kenneth McGhee voted in favor with no votes in opposition. Archie Camden and Gary Fraker were not present.

Executive Director

Sandy Sebastian

Approved by the board on

3/29-30/2016

## MOTIONS TO GO INTO CLOSED SESSION

### 1. DISCIPLINE

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (1) RSMo and 324.001.9 RSMo for deliberation on discipline

### 2. LEGAL ACTIONS/LITIGATIONS/PRIVILEGED COMMUNICATIONS

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (1) RSMo for discussing general legal actions, causes of action or litigation and any confidential or privileged communications between this agency and its attorney

### 3. PROMOTING/HIRING/DISCIPLINING/FIRING EMPLOYEES

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (3) RSMo discussing hiring, firing, disciplining or promoting an employee of this agency

### 4. DIAGNOSIS/TREATMENT OF DISCIPLINED LICENSEES

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (5) and Section 324.001.8 RSMo. for proceedings required pursuant to a disciplinary order concerning medical, psychiatric, psychological, or alcoholism or drug dependency diagnosis or treatment of specific licensees

### 5. EXAMINATION MATERIALS

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (7) RSMo for reviewing testing and examination materials

### 6. EMPLOYEE PERFORMANCE RATINGS

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (13) RSMo for making performance ratings pertaining to individual employees

### 7. APPLICATIONS

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (14) and Section 324.001.8 RSMo for discussing educational transcripts and/or test scores and/or complaints and/or audits and/or investigative reports and/or other information pertaining to the licensee or applicant for licensure

### 8. CLOSED MINUTES

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021, Subsection (14) and 324.017 RSMo for the purpose of reviewing and approving the closed minutes of previous meetings

### 9. COMPLAINTS/ INVESTIGATIVE REPORTS/AUDITS

I move that this meeting be closed and that all records and votes, to the extent permitted by law, pertaining to and/or resulting from this closed meeting be closed under Section 610.021 subsection (14) and section 620.010.14 subsection (7) RSMo for the purpose of discussing investigative reports and/or complaints and/or audits and/or other information pertaining to a licensee or applicant

Revised 09-11



Title 20-DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND  
PROFESSIONAL REGISTRATION

Division 2120-State Board of Embalmers and Funeral Directors

Chapter 3 – Preneed

PROPOSED AMENDMENT

**20 CSR 2120-3.525 [Independent Financial Advisor is Agent of Trustee] Authorized External Investment Advisor**

*PURPOSE: [This rule clarifies that an independent financial advisor is an agent of the trustee in a trust-funded preneed contract.] To set forth the qualifications and duties of an authorized external investment advisor for a preneed trust.*

- (1) An [independent financial advisor] **authorized external investment advisor**, as provided in section 436.440.6 **and 436.445**, RSMo, is an agent, as provided in section 436.440, RSMo, of the trustee.
- (2) **A preneed trust may utilize the services of an authorized external investment advisor as provided in Sections 436.435, .440 and .445, RSMo.**
- (3) **Any authorized external investment advisor utilized by a preneed trustee must have a current and active federal or Missouri registration as an investment advisor at all times when he or she serves as an investment advisor for a preneed trust.**
- (4) **Any authorized external investment advisor shall exercise his or her duties in compliance with the provisions of applicable state and federal laws including compliance with his or her fiduciary duties including the duties of loyalty and of care.**
- (5) **Except as provided in Chapter 436, RSMo, only a preneed trustee may retain the services of an authorized external investment advisor to assist the preneed trustee with the investment of preneed trust assets.**
- (6) **If a preneed trustee utilizes the services of authorized external investment advisor, that relationship shall be memorialized in a written agreement that discloses the scope of duties and powers delegated, the compensation to be paid to the authorized external investment advisor, any relationship or contracts between the authorized external investment advisor and the seller, any relationship or contract between the authorized external investment and advisor and any provider of any preneed contract for which funds are held in the seller's preneed trust, and any other provisions that the trustee deems necessary to meet its fiduciary duty to the preneed trust's beneficiaries.**
- (7) **Any independent financial advisor, in place before August 28, 2009 in compliance with the provisions of Section 436.440.6, RSMo, must be either a federally registered or Missouri registered independent qualified investment advisor at all times when acting as an investment advisor for a preneed trust and must meet all requirements required of an authorized external investment advisor..**

*AUTHORITY: sections 333.340, 436.440.6, **436.445**, and 436.520, RSMo Supp. 2009.\* Emergency rule filed Dec. 4, 2009, effective Dec. 14, 2009, expired June 11, 2010. Original rule filed Dec. 4, 2009, effective June 30, 2010.*

*\*Original authority: 333.340, RSMo 2009; 436.440, RSMo 2009; and 436.520, RSMo 2009.*



**Title 20-DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND  
PROFESSIONAL REGISTRATION  
Division 2120-State Board of Embalmers and Funeral Directors  
Chapter 3 – Preneed  
PROPOSED RULE**

**What Constitutes Adequate Records for a Seller**

- 1. A seller shall maintain the basic financial and contract records with regard to all trust and joint accounts to include the standard books of account and the supporting records that are necessary to safeguard and account for the receipt and disbursement of preneed funds.**
- 2. Adequate records for a seller to maintain shall include, at a minimum:**
  - (1) receipt and disbursement journals containing a record of deposits to and withdrawals from both preneed trusts and preneed joint accounts, specifically identifying the date, source, and description of each item deposited as well as the date, payee, and purpose of each disbursement;**
  - (2) ledger records for all preneed trust and preneed joint accounts showing, for each separate preneed contract, the source of all funds deposited, the amount of such funds, the descriptions and amounts of withdrawals, and the names of all persons or entities to whom such funds were disbursed;**
  - (3) preneed contracts, trust agreements, trust administration agreements, provider agreements, preneed agent agreements, and all correspondence related to the preneed contract;**
  - (4) accountings showing the disbursement of funds;**
  - (5) records showing disbursements;**
  - (6) the physical or electronic equivalents of all checkbook registers, bank statements, records of deposit, pre-numbered canceled checks, and substitute checks provided by a financial institution;**
  - (7) records of all electronic transfers from preneed trust or preneed joint accounts, including the name of the person authorizing transfer, the date of transfer, the name of the recipient and confirmation from the financial institution of the trust account number from which money was withdrawn and the date and the time the transfer was completed;**
  - (8) reconciliations of the preneed accounts;**
  - (9) those portions of preneed files that are reasonably related to account transactions; and**
  - (10) records of credit card transactions related to any preneed transaction to the extent permitted by law and the payment card industry data security standard.**
- 3. No seller shall commingle personal funds or other funds in a preneed trust or a preneed joint account.**

**Staff Proposed Scope of Financial Examination**  
December 8-9, 2015  
(tabled from August 4-5, 2015 and September 9-10, 2015)

**General**

1. Is the seller licensed
2. Do the preneed contracts comply with the statutes as to form
3. Are the contracts properly signed
4. Does the seller properly deposit and track payments from consumers
5. Are the books and records sufficient to show compliance
6. Does the contract match the funding source and current location of funds
7. Does the seller have contracts with its providers and are those contracts in compliance with Ch. 436
8. Does the seller maintain its fulfilled files for 5 years
9. Does the seller records match the information provided on the seller annual report. (Review seller annual reports dating from last examination to current)
10. Review 100% of contracts sold since date of last examination materials
11. Were cancellations and/or transfers in compliance with statute
12. Mail consumer letters as needed to confirm data

**Joint Accounts**

13. Are the funds held jointly as required by statute
14. Are 100% of the funds paid by the consumer in the joint account
15. Are the seller's records adequate to verify compliance

**Trust Accounts**

16. Are deposits made timely
17. Have the right amounts of money been deposited
18. Does the trust agreement give control of assets to the trustee
19. Does the trust agreement comply with the statutes
20. Have all consumer payments been deposited – to include all contracts not yet fulfilled
21. Has the seller properly requested the 5% origination fee and 10% authorized distribution.
22. Has the trust made proper disbursements

**Insurance Accounts**

23. Do the policies comply with Ch. 436
24. Is the seller the beneficiary or assignee and not the owner
25. Does the seller properly handle consumer funds

**Death Claims**

26. Does the seller have proper procedures in place for death claims
27. Does the seller timely request payment from trustee and pay death claims
28. Does the seller pay the providers by the terms of the seller/provider contract
29. Complete a 5% or minimum of 20 contract review as sampling, increasing if concerns identified.



## Board Directives for Preneed Seller Financial Examinations, beginning in 2016

### Staff Recommendation

After research, consultation with other agencies and utilizing in house resources, staff and counsel make the following recommendation for preneed seller financial exams to begin in January, 2016 and to continue until such time as the Board determines it is necessary to amend these directives:

### General Board Directives to Staff

1. Examinations are done to fulfill the Board's statutory direction in Section 436.470, RSMo, to conduct financial examinations of each preneed seller at least once every 5 years.
2. Examinations are done within the scope of the Board's statutory authority and to fulfill the Board's purpose of protecting the public by ensuring that preneed sellers are complying with their statutory requirements and duties.
3. Examinations are done for the purpose of ensuring that sellers are safeguarding preneed funds and that the funds are properly utilized per contracts with the consumer and in accord with statutory requirements.
4. Staff shall work diligently and with good faith and fairness to ensure that each financial exam is conducted lawfully and with professional conduct to fulfill the Board's directives.
5. Staff is directed to prepare a written financial exam procedures handbook to be used by all examiners in conducting financial examinations. Staff will provide the Board an update as to the status of the procedural handbook at the Fall 2016 meeting of the Board.
6. Staff may request information from sellers, as authorized by statute, as part of any financial examination, may utilize techniques required to confirm information provided by sellers including contacting preneed contract purchasers to confirm payments made and utilizing any of the other statutory authorities granted to the Board to ensure final reports on financial examinations are as accurate as possible. Staff may request information from sellers, consumers, from providers, from preneed agents, from banks and from other fiduciaries, but staff must seek Board approval to utilize any court or administrative process to require any person to comply with any staff request for information.

### Scope of Exams

7. For all preneed sellers, the examiners shall confirm:
  - a. Seller's seller license is current and active; (§ 333.320, RSMo)
  - b. Seller affirms that it has provided the Board with copies of all preneed contracts, as requested; (§ 436.420, RSMo)
  - c. Preneed contracts meet the minimum statutory requirements; (§ 436.425, RSMo)
  - d. Seller maintains adequate records of preneed contracts and related agreements; (§436.465, RSMo)
  - e. Seller provides written notification to consumers of any change in funding source; (§436.425, RSMo)

- f. Consumer funds are properly and timely deposited and consumer payments are tracked by the seller; (§§ 436.430, .450 and .456, RSMo)
  - g. Seller has contracts with its providers and trustee; (§§ 333.320 and 436.420, RSMo)
  - h. Seller maintains its fulfilled contracts and related records for 5 years; (§ 436.465, RSMo)
  - i. Seller records confirm seller's reporting on annual reports; (§ 436.460, RSMo)
  - j. Seller properly handled cancellations or transfers in accordance with statute; (§ 436.456, RSMo)
  - k. Seller complies with statutes regarding payments at death of preneed beneficiary; (§§ 436.430, .450, .455, RSMo)
  - l. The examiner shall also note in the financial examination report any other findings that the seller is not in compliance with provisions of Chapters 333, 436, RSMo, related to being a preneed seller;
  - m. Staff shall look at 100% of all active preneed contracts that have been sold since the last financial examination and may look at a sampling of other active and fulfilled preneed contracts, at the direction of the financial supervisor and Executive Director, as required to assure fulfillment of the general directives of the Board as set forth in these guidelines.
8. For trust funded preneed contracts, the examiner shall also:
- a. Confirm that the trust agreement complies with statutory requirements found in Chapters 333 and 436, RSMo.;
9. For joint account funded preneed contracts, the examiner shall also:
- a. Confirm that joint accounts are under joint control of the seller and the purchaser; (§436.455, RSMo)
  - b. Confirm that 100% of consumer paid funds are in the joint account; (§436.455, RSMo)
10. For insurance funded preneed contracts, the examiner shall also:
- a. Confirm that the seller is not the owner of the insurance policy, for preneed contracts under the new law; (§ 436.450, RSMo)

### Financial Examination Evaluation Procedures

1. For each financial examination, the examiner shall prepare a financial examination report with any necessary attachments to be submitted to the financial supervisor.
2. Upon receipt of a completed financial examination report, unless there is a need for immediate action as set forth in Sections 333.330.4 or 333.335, RSMo, Board staff shall send a copy of that financial examination report to the licensee for response and the licensee shall be given at least 30 days to file a written response with the Board. This response may dispute the findings and provide evidence to support the seller's response, it may present a plan to remedy the exceptions noted in the final examination report or it may provide any other response the seller wishes the Board to consider.
3. After the response time has passed, the financial examination report and the licensee's response shall be considered by the Examination Committee. The Examination Committee may take one of the following actions:
  - a. The Committee may accept the financial examination report if it has no exceptions or if all exceptions have been resolved and direct staff to close the exam;
  - b. The Committee may accept the seller's plan to resolve the exceptions and give the seller up to 18 months to resolve the exceptions, at the Committee's discretion;
  - c. The Committee may offer additional direction to the licensee as to what is required to resolve the exceptions and the Committee may offer the licensee additional time to resolve the exceptions, but no longer than 18 months unless there are special circumstances, at the Committee's discretion;
  - d. The Committee may refer the financial examination report and the seller's response to the full Board for further action.
4. The Examination Committee shall have no authority to seek any judicial action or to initiate any disciplinary process.
5. Upon direction by either the Examination Committee or the full Board to close a financial examination, Board staff shall provide the seller with a written notice that the exam has been closed.



Jeremiah W. (Jay) Nixon  
Governor  
State of Missouri

Kathleen (Katie) Steele Danner, Division Director  
DIVISION OF PROFESSIONAL REGISTRATION

Department of Insurance  
Financial Institutions  
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## MEMORANDUM

TO: Sandy Sebastian, Executive Director

FROM: Lisa Wildhaber, Examiner Supervisor *fw*

DATE: September 18, 2015

RE: Sampling techniques—exam processes

At their September 9, 2015 meeting, the Board requested that I research various techniques and standards for sampling of information. Listed below are various sampling options.

- 1. Statistical sampling techniques--** There are nine steps involved in designing a sample for an audit:
- 1) Define the objectives of the test
  - 2) Determine the type of test to be performed (variables sample or attributes sampling)
  - 3) Define the deviation conditions
  - 4) Define the population (decide what period will be covered, define the sampling unit, consider the completeness of the population, consider how the error rate will be extrapolated)
  - 5) Determine the method of selecting the sample (random-number sampling or systematic sampling)
  - 6) Determine the sample size
  - 7) Perform the sample (compare the sample to the population before completing the sample)
  - 8) Evaluate the sample results (interpret results, extrapolate results, consider the qualitative aspects of the deviation, and reach a conclusion about the population)
  - 9) Document the sampling procedure.

Included with this memo are further explanations of the above steps. One item to note is that general statistical sampling methods involve using a defined population, where an auditor can determine the total number in the entire population to be tested. During a preneed seller exam, while the examiner can begin by using the previously provided reports and lists as the entire population, the seller may have contracts in their possession that are NOT included on any reports/lists provided. So selecting a sample of contracts from the lists provided would not allow for finding any contracts in the population that have not been included on any reports previously provided. (These concerns are further explained in step 4, defining the population.)



## STATISTICAL SAMPLING STEPS

**1. Define the objectives of the test:** There must be a definite question to be answered. For example, do the preneed contracts contain any exceptions (lacking signatures, lacking contract numbers, funding verbiage incorrect, etc.); are consumer payments sufficiently deposited into trust or joint accounts; what percentage of contracts exist that have not been included on any reports provided by the seller (majority could be insurance assignments).

**2. Determine the type of test to be performed:** The type of sampling test to be used is determined by the conclusion the auditor is attempting to reach. **Attribute sampling** is used to answer yes/no questions; it means that the item being sampled (preneed contract) either will or won't possess certain qualities, or attributes. For example, does the contract listing provided by the seller contain all preneed contracts and are funds deposited correctly. **Variables sampling** is used to reach a conclusion about a population in terms of an amount. For example, what percent of preneed contracts are lacking signatures of all parties, or how often are preneed contracts not properly funded.

**3. Define the deviation conditions:** If we are testing for the percentage of contracts that lack a signature, a deviation would be any contract that lacks a signature. Likewise, if we are testing for underfundings, a deviation would be any contract not sufficiently funded. So in general our deviation could be any preneed contract that contains any exception.

**4. Define the population:** As mentioned earlier, defining the entire population could be difficult. An initial step would be to define the population based on the reports and contract listings provided by the seller. However, that could result in missing any other contracts in the seller's possession that are not listed on any reports/listings, whether they be insurance assignments or contracts assumed from another seller, or for some other reason.

**5. Determine the method of selecting the sample:** Using a **random-number sampling** involves either using a computer program or random number table. **Systematic selection** involves determining a uniform interval: for example, if 120 contracts need to be selected from a population of 700, then 700 divided by 120 equals 5.83, so every 6<sup>th</sup> contract would be selected.

**6. Determine the sample size:** Assuming we are using the variables sampling explained in step 2, the first question to answer: is the population homogeneous? Being homogeneous means the tendency of the items in the population is to be similar. A more homogeneous population can be tested using smaller sample sizes, while a non-homogeneous population would require larger sample sizes. Before determining sample size, the examiner must consider the risk of incorrect acceptance, confidence level, tolerable error, and expected error. [Tolerable error is the maximum number of errors in a sample size that you're prepared to accept and still conclude that you've achieved the audit objectives. Expected error is the amount of errors in your sample size that you plan for and expect. Confidence level is how sure you want to be that the selected sample is a true measure of whatever is being sampled. The sum of sampling risk and confidence level is always equal to 100: if sampling risk is determined to be 5%, then confidence level is 95%.] The table attached reflects these factors to determine sample size. For example, if we want to be 99% confident that the sample is representative of the entire population and if we can accept only a 1.0% margin of error, then a population of 10,000 items would result in a required sample size of 6,239.

If the population could include items not of interest or not to be included (such as information only files or deceased files), then the sample size should be increased, based on the estimated percentage of the non-applicable items.

**7. Perform/select the sample:** The sample is selected and the selected items are reviewed to determine if they contain deviations. Sampling guidance says to evaluate the sample to determine if it appears to be representative of the population, and expand the sample if expectations or not met. However, I don't know how this pertains to our preneed contract population, since we would have no expectations of the volume and type of possible exceptions.

**8. Evaluate the sample results:** This involves interpreting the results of the sampled items and extrapolating the results to the entire population, reaching an overall conclusion about the entire population.

**9. Document the sampling procedure:** Include in the internal exam file all the steps taken and decisions made regarding the sample.

## Required Sample Size†

Population Size	Confidence = 95%				Confidence = 99%			
	Margin of Error				Margin of Error			
	5.0%	3.5%	2.5%	1.0%	5.0%	3.5%	2.5%	1.0%
10	10	10	10	10	10	10	10	10
20	19	20	20	20	19	20	20	20
30	28	29	29	30	29	29	30	30
50	44	47	48	50	47	49	49	50
75	63	69	72	74	67	71	73	75
100	80	89	94	99	87	93	98	99
150	109	126	137	148	122	135	142	149
200	132	160	177	196	154	174	186	198
250	152	190	215	244	182	211	229	246
300	169	217	251	291	207	246	270	295
400	196	265	318	384	250	309	348	391
500	217	306	377	475	285	365	421	485
600	234	340	432	563	315	416	490	579
700	248	370	481	653	341	462	554	672
800	260	398	526	739	363	503	615	763
1,000	278	440	608	906	399	575	727	943
1,200	291	474	674	1067	427	636	827	1119
1,500	306	515	759	1297	460	712	959	1376
2,000	322	563	869	1655	498	808	1141	1785
2,500	333	597	952	1984	524	879	1288	2173
3,500	346	641	1068	2585	558	977	1510	2890
5,000	357	678	1176	3288	586	1066	1734	3842
7,500	365	710	1275	4211	610	1147	1980	5165
10,000	370	727	1332	4899	622	1193	2098	6239
25,000	378	760	1448	6939	646	1285	2399	9972
50,000	381	772	1491	8058	655	1318	2520	12455
75,000	382	776	1506	8514	658	1330	2563	13583
100,000	383	778	1513	8762	659	1336	2585	14227
250,000	384	782	1527	9248	662	1347	2626	15555
500,000	384	783	1532	9423	663	1350	2640	16055
1,000,000	384	783	1534	9512	663	1352	2647	16317
2,500,000	384	784	1536	9567	663	1353	2651	16478
10,000,000	384	784	1536	9594	663	1354	2653	16560
100,000,000	384	784	1537	9603	663	1354	2654	16584
300,000,000	384	784	1537	9603	663	1354	2654	16586

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